



# Interest from U.S. Obligations

## Questions and answers about tax-free government bonds and the Utah Individual Income Tax

### Utah State Tax Commission

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## General Information

Utah law allows taxpayers to subtract interest or dividends earned on qualifying U.S. obligations from their federal adjusted gross income. This publication identifies the types of obligations that are tax-free on the Utah individual income tax return.

## Questions & Answers

### Q: Why is the interest from U.S. obligations tax-free in Utah?

**A:** The Constitutional doctrine of intergovernmental immunity exempts federal obligations from tax by states or their political subdivisions when obligations are issued to secure credit to carry on the necessary functions of government.

### Q: What kind of unearned income is tax-free in the State of Utah?

**A:** Income from the following sources is exempt from Utah state income tax under United States laws:

- interest income on bonds or other direct obligations of the United States Government or its possessions (United States Treasury bonds, notes, bills, certificates and savings bonds);
- interest or dividends on bonds or securities of any United States authority, commission or instrumentality exempt from state income taxes under federal law. (See detailed list following these questions)

### Q: How can I tell which obligations are tax-free?

**A:** The U.S. Supreme Court under *Smith v. Davis*, 323 U.S. 111 (1944) has set forth the Smith test as a basis for determining whether instrumentalities qualify as U.S. government obligations. To qualify as an obligation of the United States, exempt from state taxation under the Smith test, the instrumentalities must:

- be written documents;
- bear interest;
- contain a binding promise by the United States to pay specific sums at specified dates; and,

- contain specific congressional authorization which also pledges the full faith and credit of the United States in support of the promise to pay.

### Q: May I deduct all of my income and dividends from tax-free U.S. obligations?

**A:** No. Exempt U.S. Government interest claimed as a deduction must be reduced by the following expenses if the expenses were claimed as deductions in arriving at your federal taxable income:

- interest on money borrowed to purchase or carry the bonds or securities;
- ordinary and necessary expenses paid or incurred in connection with producing exempt income.

### Q: How do I claim this deduction?

**A:** This deduction is taken on the line entitled "Other Deductions" on the Utah state income tax return. The deduction code is 71.

### Q: What types of securities are taxable under Utah state law?

**A:** Income from the following sources is subject to Utah state income tax:

- interest or dividends from the Federal National Mortgage Association (FNMA) and Government National Mortgage Association (GNMA);
- refunds or interest on refunds from the Internal Revenue Service or any other federal agency or department. (See below for details.)

## Exempt U.S. Obligations

- **United States Treasury bonds, notes, bills, certificates and savings bonds**
- **Banks for Cooperatives** – Income from notes, debentures, and other obligations issued by Banks for Cooperatives
- **Commodity Credit Corporation** – Interest derived from bonds, notes, debentures, and other similar obligations issued by Commodity Credit Corporation

- **Farm Credit System Financial Assistance Corporation (Financial Assistance Corporation)** – Interest from notes, bonds, debentures and other obligations issued by the Financial Assistance Corporation
  - **Federal Deposit Insurance Corporation** – Interest derived from notes, debentures, bonds, or other such obligations issued by Federal Deposit Insurance Corporation
  - **Federal Farm Credit Banks** – Income from consolidated system-wide notes, bonds, debentures, and other obligations issued jointly and severally by Banks of the Federal Farm Credit System
  - **Federal Financing Bank** – Income derived from obligations issued by the Federal Financing Bank
  - **Federal Home Loan Banks** – Interest derived from notes, debentures, bonds and other obligations issued by Federal Home Loan Banks and from consolidated Federal Home Loan bonds and debentures
  - **Federal Intermediate Credit Banks** – Income from notes, bonds, debentures, and other obligations issued by Federal Intermediate Credit Banks
  - **Federal Land Bank and Federal Land Bank Association** – Income from notes, bonds, debentures, and other obligations issued by Federal Land Banks and Federal Land Bank Associations
  - **Federal Savings and Loan Insurance Corporation** – Interest derived from notes, bonds, debentures, and other such obligations issued by Federal Savings and Loan Insurance Corporation
  - **Financing Corporation (FICO)** – Interest from obligations issued by the Financing Corporation
  - **General Insurance Fund:**
    - a. Interest derived from debentures issued by the General Insurance Fund under the War Housing Insurance Law
    - b. Interest derived from debentures issued by the General Insurance Fund to acquire rental housing projects
    - c. Interest derived from Armed Services Housing Mortgage Insurance Debentures issued by the General Insurance Fund
    - d. General Insurance Fund of the Department of Housing and Urban Development
    - e. Interest from National Defense Housing Insurance debentures issued by the General Insurance Fund
    - f. Interest from Mutual Mortgage Insurance Fund debentures issued by the General Insurance Fund
    - g. Interest from debentures issued by the General Insurance Fund under the Neighborhood Conservation Housing Insurance Law
  - **GSA Public Building Trust Participation Certificates** – Income from First Series, Series A through E; Second Series, Series F; Third Series, Series G; Fourth Series, Series H and I
  - **National Credit Union Administration Central Liquidity** – Interest from notes, bonds and debentures issued on behalf of the Central Liquidity Facility
  - **Participation Certificates in the Federal Assets Financing Trust** – Income from Series A through D, due in 1987 and 1988; and income from Participation Certificates in the Federal Assets Liquidation Trust, Series B, due in 1987, issued by the Federal National Mortgage Association as trustee (the Government National Mortgage Association is the current trustee)
  - **Production Credit Association** – Income from notes, debentures, and other obligations issued by Production Credit Association
  - **Resolution Funding Corporation** – Interest from obligations issued by the Resolution Funding Corporation
  - **Student Loan Marketing Association** – Interest derived from obligations issued by the Student Loan Marketing Association
  - **Tennessee Valley Authority** – Interest derived from bonds issued by the Tennessee Valley Authority
  - **Territorial Obligations:**
    - a. American Samoa – Interest from industrial development bonds for Eastern Samoa issued by the government of Samoa
    - b. Guam – Interest derived from bonds issued by the government of Guam
    - c. Northern Mariana – Interest derived from bonds or other obligations issued by the government of the Northern Mariana Islands
    - d. Puerto Rico – Interest derived from bonds issued by the government of Puerto Rico
    - e. Virgin Islands – Interest derived from bonds issued by the government of the Virgin Islands
- Note: Interest in the foregoing territorial obligations is not currently included in federal adjusted gross income. Therefore, interest should not be subtracted from Utah adjusted income in computing Utah taxable income.
- **United States Postal Service** – Interest derived from obligations issued by the United States Postal Service

### **The Following ARE NOT Considered U.S. Obligations (This list is NOT all-inclusive)**

- **Asian Development Bank Bonds**
- **Export-Import Bank of the United States** debentures
- **Federal Home Loan Mortgage Corporation** – Participation certificates, discount notes and guaranteed mortgage certificates
- **Federal National Mortgage Association** – Debentures, short-term notes, mortgage backed pass-through securities, and dividends from FNMA stock
- **Government National Mortgage Association** – Participation certificates, graduated payments, mortgage-backed bonds, and mortgage-backed pass-through securities
- **Interest on refunds or refunds** from the Internal Revenue Service or any other Federal Agency or Department
- **Federal or State Savings and Loan Associations**
- **International Bank for Reconstruction and Development**
- **Inter-American Development Bank**
- **Panama Canal Bonds**

## Verification Required

All deductions taken for U.S. Government interest will be subject to audit and will require you to maintain the following verification to substantiate amounts claimed:

1. Information as to specific U.S. Government obligation and related interest.
2. If the source of the U.S. Government obligation interest is from a trust, partnership, or sub chapter S corporation, a statement from the entity identifying the specific sources and amounts of interest earned must be provided. A K 1 is not sufficient to substantiate this information, unless it specifically cites the source and amount of interest.
3. If the source of the U.S. Government obligation interest is from a mutual fund, a statement from the mutual fund must be provided identifying the percent of income from the mutual fund that is derived from U.S. obligations and the specific U.S. obligations and percent of U.S. obligation interest derived from each one. A 1099 is not sufficient to substantiate this information if the 1099